Scottish Parliament
Finance and Public Administration Committee

Pre Budget scrutiny: call for views on Scotland’s public finances in 2022/23 and the impact of Covid 19

Response from ICAS

By 13 August 2021

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent over 22,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England.

2. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions relevant to Chartered Accountants.

3. We welcome the opportunity to give evidence to this call for views on Scotland's public finances in 2022/23 and the impact of Covid 19.

General comments

4. The overall background against which the 2022/23 Budget is set will be the need for funds to support the rebuilding of the economy and to maintain public services. At the same time, sources of revenues may remain reduced and fragile. The Budget in 2022/23 will need to manage the tensions arising from a desire to spend, but reduced revenues to fund that spending. Decisions on where the burdens should fall (including the balance between spending and tax increases) need to be agreed and supported by the citizens of Scotland. The Budget will also be set against the wider UK backdrop.

5. Revenues for the Scottish Budget come predominantly from the residual block grant (after adjustments) and taxation. The fiscal framework is due for renegotiation, but the Scottish Budget constraints are not unique; in broad terms they also apply to the rest of the UK. What is unique (and which drives greater complexity) is the number of moving components that make up the Scottish Budget and the need to manage these in the round. There are also the growing complexities post Brexit to factor in, where an understanding of public finances requires awareness of new arrangements, such as the internal market. These funding mechanisms are not easy to understand, making accountability and public understanding more challenging. Ensuring accountability mechanisms and public transparency keeps pace with the evolving and increasingly complex Scottish finances and decisions is important.

6. The purpose of the Scotland Act 2016 was to make the Scottish Parliament more accountable to the public, but this purpose is undermined if its policies are not understood. We believe that more should be done to improve public understanding and explain tax and spending decisions.

7. We encourage greater involvement of parliamentary subject committees in budget reviewing to support the FPAC and strengthen the alignment of evidence on service performance and outcomes to inform budget setting and prioritisation. Clearer demonstration of the outcomes achieved and impact of policy decisions is important for holding decision-makers to account.

8. We suggest that there needs to be a greater level of public debate about Scottish finances, priorities, and tax, including increased transparency about the link between raising tax revenues and paying for public services. The public debate should also cover how, and to what extent, everyone should contribute and the associated trade-offs and compromises that are part of the overall budget decisions.

9. The Scottish Government (and the UK Government) plus those involved in developing and implementing the measures introduced to ease the economic impact of coronavirus, have instigated closer and stronger collaboration with business, the professional bodies and the accountancy profession. We hope this will continue as the focus shifts to rebuilding the economy because we believe it has been beneficial.

10. As Chartered Accountants, our submission focuses on our areas of expertise: accountability, scrutiny and taxation.

Specific questions

Question 1: How should the Scottish Government's Budget for 2022-23 address the need for a fair and equal recovery from the Covid crisis?

11. For a recovery to be perceived to be fair and equal, there needs to be public support for the way in which the government raises taxation.

12. Scotland has the power to set the rates and bands at which Scottish income tax is levied but the size and shape of the Scottish income tax base is relatively small in absolute terms and in relation to the population of Scotland, which is a structural risk. The income tax base is smaller than perhaps originally anticipated and some factors that shape the base sit with the UK Government, for example, the setting of the personal allowance.

13. There are constraints and challenges in the size, shape and potential mobility of the Scottish income tax base which need to be factored in when developing tax policy; these are more limiting than many appreciate.

14. Before Covid 19 there were a number of work streams in relation to Scottish taxes, to improve the tax policy-making process and the legislative process, and to improve communications about taxes. We would like to see these recommence, which should lead to a more robust tax system with greater transparency. This in turn would increase public trust.

15. There is at present no regular process for bringing forward and considering tax legislative changes, for example a Scottish Finance Bill. It would be helpful to have such a process so that the legislation can be maintained and made to work as intended. This is important in giving taxpayers clarity and certainty that they are fulfilling their obligations. The Devolved Taxes Legislation Working Group, of which ICAS was a member, issued an interim report before the pandemic and we hope the work will be recommenced and finalised as soon as possible.

16. Something which has been innovative in Scotland is the Scottish Government's policy-making approach to taxation. A new, and in our view, successful process was used in November 2017 when the Scottish Government issued 'The role of Income tax In Scotland's Budget', prior to the Scottish Budget. This set out a number of options for exercising income tax powers and was followed by a series of round table discussions. This was a most constructive and helpful exercise, which helped to pave the way for the introduction of the new structure for Scottish income tax, with the five rates and bands. We welcome the planned recommencement of the work on a new tax policy, which has been suspended due to the pandemic.

17. There may be a desire to raise revenues through other new taxes, but we caution against the approach adopted with tourist tax and the workplace parking levy. There was limited prior consultation; any new tax should only be adopted after a robust and full consultative process.

18. The Scottish Government had been carrying out work to improve communications about tax to the general public before the pandemic. We understand this work is due to recommence, which we welcome. As noted in paragraph 8, we believe that there needs to be a better public understanding of tax and public finances and more public debate about the link between spending and taxation. Greater transparency and increased public awareness should help to generate taxpayer support.

19. In our view, the pandemic has not created a need for new tax policy and legislative processes in Scotland – this need already existed – and addressing it would help to bring visibility and buy-in to Scottish revenue raising measures.

Question 2: How should the Scottish Government's Budget address the different impacts of the pandemic across age, income and education groups and across places?

20. We have no comments on this question.

Question 3: In 2022-23, it is likely that there will be reduced levels of available Covid-related financial support for the public and private sector. Given this, what should be the priorities for the Scottish Government's Budget?

21. A key priority is to support the economy; the private sector economy needs to be as robust as possible to provide employment and wealth creation. Without this, there are limited sources of taxation revenues to provide government funds.

22. Taxation needs to both generate funds and support the economy or, at the very least, not create economic disincentives or distort behaviour.

23. Key to the longer-term ability to generate more Scottish income tax is growing the economy and hence the taxpaying base – in both absolute numbers and higher incomes. It would also be desirable to attract more higher rate and additional rate jobs and job holders to Scotland.

24. We believe that greater emphasis is needed on a longer-term financial strategy so the Scottish Government can set out its expectations and financial plans for the next 5 years to inform assessment of priorities.

Question 4: How should the Scottish Government Budget in 2022-23 address the risks arising from the level and rate of recovery from the pandemic in Scotland relative to the rest of the UK? Please consider any impact on devolved tax receipts and social security benefits in your answer.

25. The Scottish Budget comprises the residual block grant (after adjustments), tax receipts and spending commitments. There are many moving parts, each of which may have risks attaching to it that arise from the level and rate of recovery from the pandemic in Scotland relative to the rest of the UK. There is also concern about how the cumulative effect of these risks may impact on the Budget.

26. The risks include a potential requirement for different spending priorities, for instance, if there is higher unemployment than the rest of the UK, or if there is longer lasting damage to particular sectors which are more significant in Scotland. Will support for these be reflected in the block grant?

27. There is also the risk that policies may seem disjointed, or may not be understood by the public and, hence, will lack public support. Central to the overall recovery will be the interaction and coordination of roles and relationships between institutions across Scotland. Success will depend on a more collegiate approach to politics across the UK, Scotland, regional partnerships and local authorities.

28. In terms of budget scrutiny, we suggest that the Committee may need information about the ranges of possible outcomes and spending so that it can get a feel for how optimistic, realistic or pessimistic the Government is being and assess the level of preparation/ability to meet expected challenges. This is particularly important for those areas where the Government cannot control the outcome in the short term, such as tax receipts and demand-led spending such as social security. We support the progressing of the BPRG recommendations, including greater involvement of subject committees in budget scrutiny and setting.

Question 5: How has the Fiscal Framework worked in managing response to the crisis?

29. We understand the fiscal framework - 'The agreement between the Scottish Government and the United Kingdom Government on the Scottish Government's fiscal framework' - to be an agreement to:
    - coordinate sustainable fiscal policy within the UK, and
    - enable the practical operation of the legislative provisions in the Scotland Acts.

30. Through our members' work in supporting the administration and delivery of Covid 19 financial provision, we have seen additional funding coming directly into Scotland (furlough and SEISS) and also via the fiscal framework agreement (business grants).

31. However, it is not always clear how the fiscal framework has worked or delivered such funding. ICAS members have had an interest in, and input to, the Smith Commission, the Scotland Act 2016, and subsequent 'Scottish taxes' work. However, it remains the case that as tax and financial specialists, the block grant adjustments remain a mystery to many. Greater detail of how the Barnett consequentials are applied, both in terms of devolved priorities and the finances, would also help to strengthen transparency and promote understanding, trust and accountability.

Question 6: How should learnings from the pandemic inform the forthcoming review of the Fiscal Framework?

32. Pandemic funding has led to a greater desire to understand devolved finances and it would be helpful if the workings of the fiscal framework assisted in this. At present the complexity, and hence lack of understanding, of the fiscal framework and block grant adjustments, which form the underlying framework of the funding package, means that arguably there is a failure to provide clear public accountability. How much funding is in the control of the Scottish Government and what are the factors that influence this?

33. Our sense is that one learning from the pandemic is that there is more interest in the funding available for Scotland. With this in mind we note that VAT assignment, which is currently on hold, may not be satisfactory. The aim of the Smith Commission was to align a source of tax revenues with the performance of the Scottish economy but, despite much negotiation, a satisfactory methodology has yet to be identified. VAT assignment cannot be clearly linked to the Scottish Government's economic policy – and it is a moot point as to whether VAT assignment brings any benefits to either government (UK or Scottish). Any alternative proposal will require wide-ranging, full consultation.

34. With pandemic funding itself, and the interactions of benefits, tax revenues and expenditure being more volatile due to the ongoing consequences of the pandemic, it is vital that any review and subsequent revision of the Fiscal Framework is not seen as setting a framework in stone. There should be explicit provisions for either a further review or, preferably, regular reviews for at least the next decade as it may well take that long for all the impacts of the pandemic and the devolution of tax and social security to be fully worked through and understood.

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